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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

No. 73-1989

ERNEST SIMON, et al.,

Petitioners,

v.

ESTATE OF W. P. ALLEN, DECEASED, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF TEXAS

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OPINION BELOW

The opinion of the Court of Civil Appeals, reported at 497 S.W.2d 800, is set forth in Appendix A.

JURISDICTION

The judgment of the court below was entered on January 9, 1974. Timely petition for rehearing was filed, and denied on February 6, 1974. Mr. Justice Powell extended the time for filing petition for writ of certiorari to and including July 6, 1974. The jurisdiction of this

Court is invoked under Title 28, Sections 1257(3) and 1651(a) of the United States Code.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Fourteenth Amendment to the Constitution of the United States, as well as Sections 2.102 and 9.102 of the Uniform Commercial Code set forth in Appendix B.

QUESTIONS PRESENTED

1. Does due process of law under the Fourteenth Amendment permit the granting of judgment by a state court, based on a jury finding that a transaction is a sale, that a party to what is clearly understood by the parties to be a security transaction is liable as a matter of law as warranting the existence of the subject matter of collateral paper?

2. Is a presumption of liability for breach of warranty based on a jury finding of the existence of a sale valid, and in accord with due process?

3. Is the granting of damages based on mutual mistake, without proof of unjust enrichment, being contrary to our legal experience, a violation of due process?

4. Can a citizen be labelled judicially as having been guilty of fraud and conspiracy without proof being adduced, and without the basis being stated for the judgment?

5. Does the attaching by a State of a warranty of the existence of the subject matter of security documents involved in the wind-up of a financing transaction under the Uniform Commercial Code constitute an unreasonable burden on interstate commerce, in contravention of the Fourteenth Amendment?

STATEMENT OF THE CASE

This case arises from an action by the respondent estate, in which the respondent bank intervened, involving claims of breach of warranty, fraud and conspiracy, and mutual mistake, involving the following transaction. Respondents, a cotton dealer and a bank involved in the financing of cotton, arranged with one Behring, a cotton dealer and warehouseman, to take over the petitioners' financing of Behring's cotton business. This financing had, prior thereto, been handled by petitioners, based on the deposit of interstate warehouse receipts as collateral security. As a consequence of the new financing arrangements entered into by the respondents with Behring, in which the petitioners did not participate or have prior knowledge, respondents delivered to petitioners drafts in the amount of the outstanding balance of Behring's indebtedness to petitioners, who as a matter of course thereupon turned the warehouse receipts representing the collateral security over to the respondents.

Thereafter Behring defaulted on the loan of the respondents, and it was discovered for the first time that the cotton represented by the warehouse receipts was not in Behring's warehouse.

Respondents claimed against the petitioners, asserting (1) that since the petitioners treated the transactions with Behring for accounting purposes as sales, although according to everyone's understanding they were in fact financing transactions, petitioners were legally liable to respondents under the warranty provisions attending sales under the Uniform Commercial Code, (2) that having received information which should have put petitioners on notice of irregularities in Behring's dealings, petitioners were responsible for any loss resulting from the mutual mistake of the parties as to the existence of the cotton,

and (3) that petitioners were chargeable with fraud and conspiracy, although they were not aware of the non-existence of any cotton covered by the warehouse receipts, although there was no reliance on the part of the respondents, who independently developed their financing of Behring, in competition with the petitioners.

The case was submitted to a jury under special issues of fact, and the jury found that the transaction was a sale, that the petitioners had no knowledge of the missing cotton, and had not failed to disclose the facts that led to the conclusion that cotton was missing, but were guilty of bad faith. Based on these findings the trial court entered judgments against the petitioners in the amounts of $475,078.03 and $203,550.08, without making any findings or indicating the basis of said judgments. Petitioners submitted motions for judgment and for mistrial, which were denied, and petitioners appealed to the Court of Civil Appeals, which affirmed the judgment of the trial court. The federal questions involved were raised in petitioners' application for writ of error to the Supreme Court of Texas, which refused the application. Petitioners seek a writ of certiorari in light of the serious federal Constitutional issues involved.

REASONS FOR GRANTING THE WRIT

Petitioners invoke the jurisdiction of this Court on the grounds, all raised in the court below, relating to the violation of their basic rights to due process of law in the sense of fair trial in such a way as to deprive them of substantial justice under the Fourteenth Amendment to the Constitution of the United States, thereby calling for intervention by this Court. Beyond this, a precedent has been established by the courts below which, if not corrected, could have far-reaching effects on financing transactions involving warehouse receipts destined for inter-

state commerce, and in the effectiveness of the Uniform Commercial Code in facilitating such commerce.

This is a situation where, under the principles established by our legal system, no liability for damages for mutual mistake could possibly exist, since such liability has never been recognized, the only remedy available for mutual mistake being rescission, and without a showing of unjust enrichment there being no ground for the return of any consideration. Further, there was no proffer of evidence of fraud or conspiracy, and on the contrary, proof adduced by respondents of mutual mistake, negating fraud. Finally, no warranty was proved, reliance being had on the warranties incorporated in the Uniform Commercial Code with respect to sales, but under the Code this transaction, being considered by all the parties as a financing transaction, is to be treated in accordance with the intention of the parties, irrespective of any formality of treatment on the ledger of one of the parties.

Petitioners were accorded a trial, given an opportunity to present evidence in their defense, to submit proposed instructions, and to argue to the jury. It is what happened thereafter that gave rise to the errors raised by petitioners, errors which go to the root of due process, and are of such importance as to call for review by this Court. Based on the jury findings, the trial court found in favor of the respondents and entered judgments against petitioners totalling $678,628.31.

In presuming legal liability for breach of warranty under the Code from the jury's finding of the existence of a sale, the courts below have exceeded the permissible reach of a proper presumption. The jury was asked to make a finding as to whether the transaction involved a sale, under the Texas procedure whereby fact findings are confided to the jury on the basis of special issues to

be determined by them. The trial court without the benefit of any further fact findings on the warranty issue found for the respondents.

Legislative fiat may not take the place of fact in the determination of issues involving life, liberty or property. A statute creating a presumption which is arbitrary is void. In the application of a statute in such a way as to declare the proof of one fact as evidence of the ultimate fact of liability, there must be a rational connection between the proven fact and the conclusion to be drawn therefrom.

For example, a statute treating the breach of a labor contract as *prima facie* evidence of an intent to defraud an employer was held to be an unconstitutional presumption. *Bailey v. Alabama,* 219 U.S. 219, 233. Similarly, the Court held that since an inference of criminal guilt may not be drawn from the inability on the part of a bank to pay demand deposits and other debts as they matured, a statute making proof of insolvency *prima facie* evidence of fraud on the part of a bank director was arbitrary and unconstitutional. *Manley v. Georgia,* 279 U.S. 1, 7. The Court also voided a Georgia statute which declared a railroad liable in damages for the operation of trains unless it could show that its agents exercised ordinary diligence. *Western & Atlantic R. Co. v. Henderson,* 279 U.S. 639.

Basically, the transaction involved in this case was a transfer of warehouse receipts held by petitioners as collateral security for a loan to respondents as a consequence of the tender by respondents to petitioners of payment in satisfaction of the outstanding indebtedness. It is this transaction which the jury found to be a sale.

If the Uniform Commercial Code required that from a fact finding that such a transaction is a sale, it be further found that the transferor warrants the continued existence of the subject matter of the documents given as collateral security, irrespective of any showing of the circumstances, including knowledge or reliance, the statute would be unconstitutional, since it would run counter to both logic and experience, as reflected in our legal system. No court in this country has so construed the Uniform Commercial Code, and there is no indication that the framers ever considered this possibility.

There are two other important considerations. The first is the size of the judgments against the petitioners, who were never found to have received any money beyond that owed to them by Behring or to have been in any manner unjustly enriched. The amount is so staggering as to cause the cessation of business as cotton merchants by the respondents, and bankruptcy, their only alternative, is not available to them since the benefit of the bankruptcy statutes is specifically excluded with respect to judgments for fraud.

The Court has held that "fair play" and "substantial justice" are the touchstones of due process. *International Shoe Company v. State of Washington,* 326 U.S. 310, 316, 317. Due process is not satisfied by compliance with technical form. *Carter v. People of State of Illinois,* 529 U.S. 173, *Foster v. People of State of Illinois,* 332 U.S. 134. The Court must, then, decide whether what occurred in this case is sufficiently serious to rise to the level of lack of fair play and denial of substantial justice.

Petitioners have been tagged with the stigma of fraud, one of the causes of action on which the trial judge found against them in fact and law, without specifying any particular cause of action, so that fraud and conspir-

acy are an integral part of the judgment. Particularly in cases involving fraud, justice requires that the basis for the judgment be stated, and the failure to do so, as in this case, is a denial of fundamental fairness in the sense of due process. Cf. *American Railway and Express Company v. Kentucky*, 273 U.S. 269, 273, *United Transport Union v. State Bar of Michigan*, 401 U.S. 576, 583. In fact, respondents abandoned the fraud and conspiracy counts in their arguments to the jury, although they have not hesitated to rely on the fraud count in their briefs to the courts below. In such a state of the record, a reputable business man would hesitate to deal with the petitioners, who have been forced to go out of business as cotton merchants.

Where the action of a State attaches a "badge of infamy" to a citizen, due process comes into play. *Wisconsin v. Constantineau*, 400 U.S. 433, 437, *Wieman v. Updegraff*, 344 U.S. 183, 191. It is not necessary that the stigma and hardship of a criminal conviction be involved to invoke this principle. *Anti-Fascist Committee v. McGrath*, 341 U.S. 123. Due process of law was intended to secure the individual from arbitrary exercise of the powers of government unrestrained by established principles of private rights and justice. *Twining v. New Jersey*, 211 U.S. 100, 101.

Petitioners stand labelled with conspiracy and fraud, when all they did was to accept payment of indebtedness due them, and deliver collateral security documents as they were legally required to do. Would any community consider this ministerial act the basis for a charge of breach of warranty as to the existence of the goods covered by the documents, let alone fraud and conspiracy, destroying the very livelihood of the petitioners. To affix such responsibility to such a limited function would, in the terms employed by Justice Holmes, be

more than the community could bear. *The Common Law,* Oliver Wendell Holmes, Jr. (1881), page 50.

Certainly it was never the intention of the framers of the Uniform Commercial Code to impose such responsibility. Although section 2.106 defines a sale as the passing of title for a price, both sections 2.102 and 9.102 exclude from the provisions of Chapter 2 any transaction intended as a security transaction, as the uncontroverted evidence showed to be true in this case.

The purpose of the Code was to provide uniformity in the law relating to commercial transactions throughout the country, as well as minimize uncertainties in dealings across state lines. The result of the judgments of the courts below must be to cast a pall over security transactions involving collateral unless the lending party has possession of the collateral. Henceforth, if the judgments of the courts below are allowed to stand, a party receiving payment and returning security documents may be held responsible as warranting the merchandise represented by those documents. Such a result must have an effect on interstate commerce, and call for review by the Court.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

OPINION OF THE COURT BELOW

Ernest SIMON et al., Appellants,

v.

ESTATE of W. P. ALLEN, Deceased, et al., Appellees.

No. 5225.

Court of Civil Appeals of Texas, Waco.

July 12, 1973.

Rehearing Denied Aug. 9, 1973.

* * *

HALL, Justice.

This action was brought by Elizabeth F. Allen, Individually and as Independent Executrix of the Estate of W. P. Allen, Deceased, against Ernest Simon, Ernst Cohn & Co., and Melvin A. Behring and Arthur H. Behring, dba Behring & Behring, to recover damages allegedly suffered by her husband as the result of an asserted purchase by him on September 14, 1966, of several thousand warehouse receipts from Cohn & Co. which represented bales of cotton stored in the warehouse of Behring & Behring. First City National Bank of Houston, Texas, (hereinafter "First City" or "Bank") intervened, alleging that it advanced the money to Allen with which he made the purchase from Cohn & Co., that Allen pledged the receipts "and the cotton purportedly covered thereby" to the Bank as security for the loan; and among other things, that it sustained damages as the re-

sult of a "mutual mistake" on the part of Simon, Cohn & Co. and the Bank, regarding an alleged lack of cotton behind some of the warehouse receipts.

The record shows without dispute that Behring & Behring was a partnership, but that all of its activities were conducted solely by Melvin A. Behring. Therefore, our reference to Behring will mean Melvin Behring and the partnership.

Under the name of Allen and Company, Allen operated as a successful cotton broker in Houston for over thirty years. Behring was located in Dallas. He bought and sold cotton. Additionally, he was the owner of several cotton warehouses. Simon, a Houston resident, through Cohn & Co., also functioned as a cotton merchant. Allen, Simon individually, and Cohn & Co., all banked with First City. Behring banked at Dallas.

Allen began financing Behring in 1960. The source of Allen's funds was First City. Simon, through Cohn & Co., also financed Behring during 1966. Simon's source of money was also First City. Henry Oliver, a senior vice-president of First City, handled the transactions with Allen and Simon on behalf of the Bank.

Unlike Allen's financing arrangements with Behring, the dealings between Behring and Simon were not straight-forward financing transactions, but were structured by them to appear as purchases and sales of cotton. When Behring paid a loan, Cohn & Co. returned receipts to Behring by means of a sales invoice to Toyo Cotton

Company a large cotton firm operating in Dallas. This arrangement gave the outward impression that Cohn & Co. was a successful cotton merchant doing a large volume of sales. The cotton involved was stored in Behring's warehouses. This permitted him to remove the cotton from storage without redeeming or canceling the warehouse receipts held by Allen, Cohn & Co., and the Bank. Under written agreements with Behring, Simon expressly reserved the right to sell the cotton evidenced by the warehouse receipts held by Cohn & Co. at any time.

Around the 1st of September, 1966, Cohn & Co. began invoicing the cotton directly back to Behring, rather than through Toyo, but still using sales invoices. By this time Behring was experiencing serious financial difficulties, and Simon had become increasingly concerned and anxious regarding Behring's payments of his obligations to Cohn & Co. Finally, drafts drawn by Cohn & Co. on Behring on September 7th for $250,142.61, and on September 8th for $276,096.88, both with sales invoices and warehouse receipts attached, which had been deposited to the account of Cohn & Co. at First City and upon which immediate credit had been granted by the Bank, were dishonored by Behring.

Between September 9th and September 13th, checks totaling about $550,000 were given by Behring to Allen. Allen deposited the checks with First City and was given immediate credit. The checks were returned because of insufficient funds.

On September 13, 1966, Behring went to Houston and met with Allen and Oliver to discuss payment of the bad checks he had given to Allen. The meeting culminated in an agreement by Allen to borrow enough money from the Bank to purchase the cotton represented by the warehouse receipts which were attached to the Cohn & Co./Behring Drafts of September 7th and 8th, and to purchase another group of warehouse receipts covering an additional 3,775, bales of cotton (with an invoice value of $343,052.74) which was the balance of the Behring cotton held by Cohn & Co. The Bank's loans to Allen that day, when added to his prior indebtedness, created a total indebtedness by him to First City of $1,585,066.42.

On the evening of September 13th, Oliver told Simon by telephone of the arrangement that had been made for Allen to buy all the Behring cotton from Cohn & Co. The next day, Allen delivered two checks aggregating $870,336.80 to Simon in payment of the warehouse receipts that were attached to the unpaid drafts of September 7th and 8th, and in payment of the additional sales invoice held by Cohn & Co. on Behring cotton.

The two checks from Allen were deposited to the Cohn & Co. account at First City. Cohn & Co. paid the Bank $526,707.89 to clear the drafts of September 7th and 8th, which had been charged back to the account of Cohn & Co. when not paid by Behring, together with minor charges for handling the drafts and their dishonor. Within one week following September

14th, Simon withdrew $267,850 from the account of Cohn & Co. and deposited it to his personal account.

On November 4, 1966, Allen discovered that much of the cotton represented by the warehouse receipts he received from Cohn & Co. was missing. Soon thereafter Behring filed an application in bankruptcy. In early December, Allen died.

Trial was to a jury. Answering special issues numbered as follows, it made findings, among others, that:

(1, 2, 3, and 4). On September 14, 1966, Cohn & Co. transferred the questioned warehouse receipts to Allen and sold the cotton represented by the receipts to Allen.

(5, and 7). 7,459 bales of cotton represented by the warehouse receipts were missing from the warehouse at the time of the transfer and sale from Cohn & Co. to Allen.

(6 and 8). Allen paid Cohn & Co. $678,628.31 for the missing bales.

(31). First City granted, and Cohn & Co. withdrew, the immediate credits created by the deposit of the drafts dated September 7th and September 8th, 1966, totaling $526,377.61, as a result of a mutual mistake of fact.

Judgment was rendered on the verdict in favor of plaintiff and First City against Simon, Cohn & Co., and Melvin A. Behring, jointly and severally, for $475,078.03;

and for plaintiff against Simon, Cohn & Co., and Melvin A. Behring, jointly and severally, for the additional sum of $203,550.28; and for plaintiff against Melvin A. Behring for the further sum of $412,248.26. Plaintiff's suit against Arthur H. Behring was dismissed with prejudice, apparently upon plaintiff's motion.

Only Simon and Cohn & Co. have appealed. In 28 points of error they challenge certain actions of the trial court, and some of the findings, and the judgment, for sundry reasons. We affirm the judgment.

Pertinent, here, V.T.C.A., Bus. & C., provides as follows:

> Sec. 7.507. Where a person . . . transfers a document of title for value [otherwise than as a mere intermediary acting with authority and in good faith], then unless otherwise agreed he warrants to his immediate purchaser . . . (3) that his . . . transfer is rightful and fully effective with respect to the title to the document and the goods it represents.

> Sec 2.313. (a) Express warranties by the seller are created as follows: . . . (1) Any affirmation of fact . . . made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation . . . (2) Any description of the goods which is made part of the basis of the bargain

creates an express warranty that the goods shall conform to the description . . .

Sec. 2.314. [A] warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind . . .

Sec. 2.711. Where the seller fails to make delivery . . . then with respect to any goods involved . . . the buyer may . . . [recover] so much of the price as has been paid.

Appellants argue without benefit of jury finding that Cohn & Co. was only an "intermediary" in its dealings with Allen; and that there was no "sale" of cotton by the Company to Allen as found by the jury.

[1] Appellants have no points of error in which they assert that the jury's answers to special issues 1 through 8 are not supported by the evidence, or that those answers should be disregarded for any reason. The only complaints presented by points of error that relate to those issues deal with the failure of the trial court to define "sale" and "transfer" as requested by appellants in their objections to the charge. No definitions of the words were submitted by appellants to the trial court. Thus, any error in the court's failure to define the terms was waived. Rule 279, Tex.Rules Civ.Proc. The findings reflected by the answers to the first eight issues stand unchallenged by appellants.

[2] Cohn & Co. made express warranties of quantity by stating on its three invoices in question the number of bales of cotton sold thereby, totaling 9,612 bales. When Cohn & Co. sold nonexistent cotton to Allen, as found by the jury, it breached both express and implied warranties set forth in the Texas Business and Commerce Code, supra; and thereby rendered itself liable to Allen for at least the amount he paid therefor. This is sufficient to support the judgment awarded plaintiff against Cohn & Co.

[3] Appellants contend that the evidence is legally and factually insufficient to support the finding that the granting of immediate credits by First City on the drafts of September 7th and 8th, and Simon's withdrawal thereof, resulted from a mutual mistake of fact. We disagree. Oliver testified that if he had possessed any knowledge or suspicion "of the shortage of cotton behind these warehouse receipts," then he would not have allowed Cohn & Co. credit on the drafts. Simon testified that when he entered into the transactions on September 7th, 8th and 14th, he believed there was cotton behind the receipts; and that if he had known otherwise he "would not have entered into any transaction with the bank." There is other evidence supporting the finding, and in the light of the entire record it is not against the great weight and preponderance of the evidence.

[4] One who has entered into a contract as the result of a mutual mistake of a

material fact may avoid the contract and recover the damages he has suffered thereby. 38 Tex.Jur.2d 741, Mistake, Sec. 4. Judgment for the Bank on the ground of mutual mistake was proper.

[5] Simon says that judgment should not have been rendered against him, individually. The record shows without dispute that at the time in question Simon owned 99.6% of the stock of Cohn & Co.; that he was its president and exercised complete and independent control of the company, and that it was merely a conduit for the transaction of what was actually his own private business. These circumstances support the conclusion of the trial court that he should be held personally liable for the corporate transactions. Moore v. Savage (Tex.Civ.App., 1962) 359 S.W. 2d 95, 97, writ refused, n.r.e. (Tex.Sup., 1962), 362 S.W.2d 298; 14 Tex.Jur.2d 134, Corporations, Sec. 13.

We have carefully considered, and overrule, appellants' remaining points of error. In some, the matters complained of have not been preserved for appellate review; the others do not present reversible error.

The judgment is affirmed.

APPENDIX B

STATUTORY PROVISIONS INVOLVED

§ 2.102. Scope; Certain Security and Other Transactions Excluded From This Chapter

Unless the context otherwise requires, this chapter applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this chapter impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers. (59th Legis., Ch. 721, Sec. 2—102.)
Acts 1967, 60th Leg., vol. 2, p. 2343, ch. 785, § 1.

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§ 9.102. Policy and Scope of Chapter

(a) Except as otherwise provided in Section 9.103 on multiple state transactions and in Section 9.104 on excluded transactions, this chapter applies so far as concerns any personal property and fixtures within the jurisdiction of this state.

(1) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper, accounts or contract rights; and also

(2) to any sale of accounts, contract rights or chattel paper.

(b) This chapter applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This chapter does not apply to statutory liens except as provided in Section 9.310.

(c) The application of this chapter to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this chapter does not apply. (59th Legis., Ch. 721, Sec. 9—102.)
Acts 1967, 60th Leg., vol. 2, p. 2343, ch. 785, § 1.